



June 1, 2006

Robert J. Allard, Jr.  
City Assessor  
City Hall  
455 Main St.  
Worcester, MA 01608

Re: Affordable Housing Valuation  
Our File No. 2005-87

Dear Mr. Allard:

This is in reply to your letter seeking guidance on the proper valuation of property with an affordable housing restriction. It is our understanding that Worcester Common Ground, Inc. ("WCG"), a non-profit community land trust organization dedicated to creating affordable housing for low to moderate income families, rehabilitated three, attached, multi-unit row houses located on Austin St. in Worcester and sold them at below-market prices subject to deed restrictions and ground leases. Each building sold for \$145,000.00. The deed restrictions require each purchaser to accept certain limits regarding the resale of his or her building. WCG also leased the land associated with each building subject to the terms of a 99-year ground lease. The ground lease provides that each purchaser must grant to WCG a right of first refusal on the building in the event that he or she intends to sell. The sale price of a building is limited to the initial purchase price plus 60% of the increase in fair market value of improvements, such as buildings, structures and fixtures, and 100% of the increase in fair market value of improvements attributable to additions and enhancements to the living space. If WCG exercises its right of first refusal, the building may be offered at the same sale price to qualifying low or moderate income residents. The ground lease also prescribes the amount of rent that an owner-occupant may charge to qualifying low or moderate income residents as tenants. These income and rental restrictions are encumbrances on the properties and must be assumed by any subsequent transferees.

As you know, the valuation standard used in assessing property is fair cash valuation.<sup>1</sup> This means "fair market value, which is the price an owner willing but not under compulsion to sell ought to receive from one willing but not under compulsion to buy."<sup>2</sup> Your opinion of fair market value of each property is approximately \$225,000. However, you question whether the properties' values should be discounted because of the restrictions in the deeds and the ground leases.

There is no statute or regulation dealing with the issue of what exactly constitutes the property value subject to tax when there are encumbrances and restrictions in deeds, leases or other agreements. However, such issues have been addressed in Massachusetts by various court decisions. The courts have long distinguished between those provisions affecting the use and enjoyment of the real estate itself, and therefore, its value to any hypothetical purchaser in the open market, and those affecting the economic benefits a particular owner can obtain from the property.

Provisions affecting the use and enjoyment of the property must be considered by the assessors in any determination of the property's fair cash valuation whether they arise from private or governmental action.<sup>3</sup> Provisions affecting the income or return a particular owner may derive from the property are generally not to be considered.<sup>4</sup> One exception to this rule, however, is that governmental policies or actions that regulate the return a property can produce and also promote important public interests are factors that must be taken into account in valuing the property.<sup>5</sup> The theory behind this

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<sup>1</sup> See G.L. c. 59, § 38.

<sup>2</sup> *Boston Gas Co. v. Assessors of Boston*, 334 Mass. 549 (1956).

<sup>3</sup> See *Lodge v. Swampscott*, 216 Mass. 260 (1913)(deed restriction prohibiting building any structure on the land reduced its fair cash value); *Parkinson v. Board of Assessors of Medfield*, 398 Mass. 112 (1986)(the effect of a conservation restriction must be taken into account in determining the fair cash value of property); see also *Mashpee Wampanoag Indian Tribal Council, Inc. v. Board of Assessors of Mashpee*, 379 Mass. 420, 422 (1980)("... the existence of restrictions on the use of property may reduce its value below that which would be appropriate in the absence of such restrictions.").

<sup>4</sup> See *Donovan v. Haverhill*, 247 Mass. 69 (1923)(a long-term, disadvantageous lease does not constitute an encumbrance that diminishes the property's value for tax assessment purposes); *Pepsi-Cola Bottling Co. v. Assessors of Boston*, 397 Mass. 447 (1986)(the property should be valued as though it were not encumbered by an unfavorable lease); see also *Sisk v. Board of Assessors of Essex*, 426 Mass. 651 (1998)(lease restriction on town-owned land was not required to be considered when determining the value of the property for local taxation purposes).

<sup>5</sup> See *Board of Assessors of Weymouth v. Tammy Brook Company*, 368 Mass. 810 (1975)(in determining the fair cash value of the property, it was appropriate to consider the Federal restrictions on the income that could be realized from the project); *Community Development Co. of Gardner v. Assessors of Gardner*, 337 Mass. 351 (1979)(the restrictions placed by Federal regulations on the rent the company could receive from the housing project had to be taken into account in valuing the property); *Truehart, et al. v. Assessors of Montague*, Appellate Tax Board Docket Nos. 198055-57 (April 21, 1999)(proper valuation of single family homes purchased

exception seems to be that since the Legislature has indicated support for these policies and actions, it would be inconsistent with the legislative purpose not to take the restrictions into account in determining value.

Whether a private, voluntary agreement by a developer to be bound by sale and rent restrictions diminishes the property's value for assessment purposes remains an open question. This type of encumbrance affects the owner's interest, not the use and enjoyment of the property. In Massachusetts, property taxes are assessed on the unencumbered fee, not on the rights held by the owner of the fee.<sup>6</sup>

The restrictions at issue here do not limit or impair the ability of the current or any prospective owners to use the property for residential purposes. It could also be argued that these restrictions are not the kind of governmental restrictions that affect a property's value. Most government restrictions are "imposed" on properties in the exercise of the government's regulatory powers. Such regulations generally affect the use and earning capacity of the property in the hands of any hypothetical owner and, as a result, influence the price a prospective purchaser would pay for the property. The sale and rent restrictions at issue here were not imposed on the property by law without the owners' consent. The property owners here agreed to give WCG a right of first refusal and to limit the amount they realized from any sale or rental of their properties in exchange for the opportunity to purchase the properties at an affordable price. Provisions that impact the economic benefits an owner can obtain from property are not generally reflected in the property's assessed valuation.

On the other hand, the properties in question probably would not exist as affordable housing units without the types of sale and rent restrictions used by WCG, and the failure to reflect those restrictions in assessed valuations would be inconsistent with the objectives of the housing assistance program. Further, a willing buyer would not be willing to pay fair market value for a property if sale and rental restrictions limit the return on the property to well below fair market value. In addition, fair cash value assessments that exceed the amount that holders of restricted interests can command in actual sales might result in a decrease or cessation of affordable housing projects.<sup>7</sup> Therefore, it could be argued that the property should be taxed as the property encumbered.

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pursuant to a government program, which restricted the sale price, required the deed restrictions to be taken into account).

<sup>6</sup> *Donovan v. Haverhill*, 247 Mass. 69, 71 (1923)(property taxes are assessed on the "whole land and not merely the interest of the person taxed.").

<sup>7</sup> In *Community Development Co. of Gardner*, 337 Mass. at 355, the court commented that "[a]t the board [of assessors] hearing, there was evidence that the company would be forced to default on the mortgage for the housing project if the valuation of the project were based on "fair market rentals."

While no Massachusetts case has addressed the effect for local property tax purposes of the type of affordable housing restrictions at issue here, a New Jersey case has held that a property tax assessment must account for restrictions on the resale value of county sponsored affordable housing units. In *Prowitz v. Ridgefield Park Village*, 237 N.J. Super 435 (App.Div. 1989), *aff'd*, 122 N.J. 199 (1991), the court held that the restrictions on the purchasers' resale rights constituted a burden on land that had to be considered in determining the assessed values of properties. The *Prowitz* case viewed the restrictions upon resale value, rents, and transferability as encumbrances restricting the use and benefit of the property as effectively as any deed restriction or covenant. Most other states do the same. In fact, the majority of cases from other states hold that, in valuing affordable or low-income housing projects, the assessors should separately consider the negative effects of the restrictions placed on the owners such as rent ceilings, resale values, limitations on income distributions, and restrictions on transferability.<sup>8</sup>

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<sup>8</sup> See e.g., *In Re Appeal of Johnstown Associates*, 494 Pa. 433 (1981)(rent and sale restrictions are factors unique to subsidized property and clearly relevant to the question of value); *Steele v. Town of Allentown*, 124 N.H. 487 (1984)(federally subsidized housing should be valued as such and not as non-subsidized housing); *Kankakee County Bd. of Review v. Property Tax Appeal Bd.*, 131 Ill.2d 1 (1989)(in valuing a government-subsidized apartment building, the taxing authority had to weigh both the positive and the negative elements and adjust the actual income figure to accurately reflect the property's true earning capacity); *Rebelwood, Ltd. v. Hinds County*, 544 So.2d 1356 (Miss. 1989)(because the benefits of participating in a federal low-income housing program affect the value of the property in the open market, they must sensibly be considered in assessing the value); *Meadowlanes v. Holland*, 437 Mich. 473 (1991)(interest subsidy payments made by the government in return for the rent restrictions affect the selling price of the property and should have been considered in the property's valuation); *Metropolitan Holding Co. v. Board of Review of Milwaukee*, 173 Wis. 2d 626 (1993)(property assessment for low-income housing should be based on actual rents and expenses); *Glenridge Development v. City of Augusta*, 662 A.2d 928 (Me. 1995)(taxing authority should consider the effect of the regulations governing the housing complex); *Bayridge Assoc. Ltd. Partnership v. Department of Revenue*, 321 Ore. 21 (1995)(participation in a federal low-income housing tax credit program is a governmental restriction as to use and must be considered in valuing property); *Greenfield Village Apts. L.P. v. Ada County*, 130 Idaho 207 (1997)(property valuation should consider the restricted use of the land as low-income and rent restricted); *Parkside Townhomes Assocs. v. Board of Assessment Appeals*, 711 A.2d 607 (Pa. Commw. 1998)(the fair market value of property is a function of the economic reality which includes the effects of tax credits for low-income housing); *Pedcor Investments v. State Bd. of Tax Commissioners*, 715 N.E.2d 432 (Ind. Tax Ct. 1999)(deed restrictions may constitute economic obsolescence depending on the effect of the tax incentives); *Penns Grove Gardens Ltd. v. Penns Grove Borough*, 18 N.J. Tax 253 (1999)(governmental contract rent and actual management fee should be used in determining valuation); *In re Ottawa House. Assoc.*, 27 Kan. App. 2d 1008 (2000)(taxing authority should have considered the effects of the low-income housing contract when it valued the property for ad valorem taxes); *Town Square Ltd. Partnership v. Clay County Bd. of Equalization*, 2005 SD 99 (2005)(both the restricted rents and the tax credits had to be considered when assessing property operating under federal low-income housing tax credit program); but cf., *Alliance Towers, Ltd. v. Stark County Bd. of Revision*, 37 Ohio St. 3d 16 (1988)(the artificial effects of government housing assistance programs are not indicative of the valuation of real estate); *New Walnut Square Ltd. Partnership v. Louisiana Tax Commission*, 626 So. 2d 430 (La. Ct. App. 4<sup>th</sup> Cir. 1993)(assessor did not have to consider separately the existence of a rent ceiling and a limit on distributions from income); *Piedmont Plaza Investors v. Dep't of Revenue*, 331 Ore. 585 (2001)(assessment best calculated without making adjustment for the federal

As the cases indicate, however, whether the operation of a non-governmental affordable housing program is intended to provide the participants with a tax reduction still remains an open question in much of the country. In the absence of any legislation in Massachusetts addressing exactly what constitutes the property value subject to tax when there are private, voluntary, contractual restrictions in deeds, leases or other agreements, we cannot say with certainty whether a determination of fair cash valuation requires taking into account the economic effect of resale and rent restrictions associated with affordable housing properties. While the legal arguments for not considering such restrictions are strong, we also note that Massachusetts courts have given substantial weight to the important public policy advanced by *government* sponsored housing assistance programs.<sup>9</sup> In addition, private deed restrictions limiting the value of property have been judicially recognized.<sup>10</sup> Thus, while the maximum resale price does not necessarily define fair cash value<sup>11</sup>, the trend among the Massachusetts courts appears to be to take affordable housing restrictions affecting the right to benefit from a property into account in assessing value.

We hope that this information is helpful. If you have any additional questions concerning this matter, please do not hesitate to contact us.

Very truly yours,

A handwritten signature in black ink, appearing to read "Kathleen Colleary", written in a cursive style.

Kathleen Colleary, Chief  
Bureau of Municipal Finance Law

KC/mcm

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interest subsidy); *In the Matter of the Appeal of: The Greens of Pine Glen Ltd. Partnership*, 356 N.C. 642 (2003)(because the federal low-income tax housing tax credit program's restrictions were freely entered contractual covenants, not governmental regulations, the taxpayer was not allowed to artificially alter the value of its property below fair market value).

<sup>9</sup> See fn. 5 above.

<sup>10</sup> See fn. 3 above.

<sup>11</sup> See *Truehart, et al.*, Docket No. 198055, 198056 and 198057 (April 21, 1999); see also *Boston Edison Company v. Board of Assessors of Watertown*, 387 Mass. 298, 302-06 (1982).